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BEFORE THE ARIZONA CORPORATION CO.

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IN THE MATTER OF THE APPLICATION OF
GLOBAL WATER – PALO VERDE UTILITIES
COMPANY FOR THE ESTABLISHMENT OF
JUST AND REASONABLE RATES AND
CHARGES FOR UTILITY SERVICE DESIGNED
TO REALIZE A REASONABLE RATE OF
RETURN ON THE FAIR VALUE OF ITS
PROPERTY THROUGHOUT THE STATE OF
ARIZONA.

Docket No. SW-20445A-09-0077

IN THE MATTER OF THE APPLICATION OF
VALENCIA WATER COMPANY – GREATER
BUCKEYE DIVISION FOR THE
ESTABLISHMENT OF JUST AND REASONABLE
RATES AND CHARGES FOR UTILITY SERVICE
DESIGNED TO REALIZE A REASONABLE RATE
OF RETURN ON THE FAIR VALUE OF ITS
PROPERTY THROUGHOUT THE STATE OF
ARIZONA.

Docket No. W-02451A-09-0078

IN THE MATTER OF THE APPLICATION OF
WILLOW VALLEY WATER COMPANY FOR THE
ESTABLISHMENT OF JUST AND REASONABLE
RATES AND CHARGES FOR UTILITY SERVICE
DESIGNED TO REALIZE A REASONABLE RATE
OF RETURN ON THE FAIR VALUE OF ITS
PROPERTY THROUGHOUT THE STATE OF
ARIZONA.

Docket No. W-01732A-09-0079

IN THE MATTER OF THE APPLICATION OF
GLOBAL WATER – SANTA CRUZ WATER
COMPANY FOR THE ESTABLISHMENT OF
JUST AND REASONABLE RATES AND
CHARGES FOR UTILITY SERVICE DESIGNED
TO REALIZE A REASONABLE RATE OF
RETURN ON THE FAIR VALUE OF ITS
PROPERTY THROUGHOUT THE STATE OF
ARIZONA.

Docket No. W-20446A-09-0080

Arizona Corporation Commission

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1 IN THE MATTER OF THE APPLICATION OF
2 WATER UTILITY OF GREATER TONOPAH FOR
3 THE ESTABLISHMENT OF JUST AND
4 REASONABLE RATES AND CHARGES FOR
5 UTILITY SERVICE DESIGNED TO REALIZE A
6 REASONABLE RATE OF RETURN ON THE
7 FAIR VALUE OF ITS PROPERTY THROUGHOUT
8 THE STATE OF ARIZONA.

Docket No. W-02450A-09-0081

5 IN THE MATTER OF THE APPLICATION OF
6 VALENCIA WATER COMPANY – TOWN
7 DIVISION FOR THE ESTABLISHMENT OF JUST
8 AND REASONABLE RATES AND CHARGES
9 FOR UTILITY SERVICE DESIGNED TO
10 REALIZE A REASONABLE RATE OF RETURN
11 ON THE FAIR VALUE OF ITS PROPERTY
12 THROUGHOUT THE STATE OF ARIZONA.

Docket No. W-01212A-09-0082

10 RUCO'S CLOSING BRIEF

11 INTRODUCTION

12 The Residential Utility Consumer Office ("RUCO") submits this Brief in response to
13 Global Water's ("Global Water," "Global," "Global Utilities," or "Company") request that the
14 Arizona Corporation Commission ("Commission") authorize a rate increase for the
15 Company's Palo Verde Water Company ("PVWC"); Valencia Water Company ("VWC")
16 (Valencia-Town and Valencia-Buckeye); Willow Valley Water Company ("WVWC"); Santa
17 Cruz Water Company ("SCWC") and Greater Tonopah Districts ("WUGT").

18 Total Water Management ("TWM") – Global's visionary approach to managing scarce
19 water resources in high-growth areas is a wonderful idea and truly deserves attention. A-7 at
20 20¹. However, its implementation should not come at a cost that is unfair to the Company's
21 ratepayers. From the Company's perspective, this case is about TWM, and not about "... rate

22
23 ¹ For ease of reference, trial exhibits will be identified similar to their identification in the Transcript of
24 Proceedings. The Transcript volume number and page number will identify references to the Transcript.

1 base, expenses, and rate of return.” A-8 at 2. Nonetheless, to achieve TWM, the Company
2 is asking the Commission to approve accounting gimmicks which result in nothing more than
3 substantially higher rates for ratepayers. Specifically, to achieve TWM, the Company is
4 asking the Commission, for ratemaking purposes, to turn a blind eye to the financial impact
5 on Global Utilities from the proceeds of Infrastructure Coordination and Financing
6 Agreements (“ICFA”) entered into between Global’s parent company (“Global Parent”) and
7 landowners. The Company’s proposed accounting treatment of the ICFA proceeds (or lack
8 of accounting treatment) is really a transparent attempt by the utility and its parent to avoid
9 the effect on Global’s ratebase that normally occurs when a utility receives Contributions In
10 Aid Of Construction (“CIAC”) – i.e. a reduction to the ratebase. A reduction in ratebase
11 translates to lower rate for ratepayers.

12 From the onset, it should be pointed out that most of what Global claims are issues
13 that face the water industry in Arizona that RUCO agrees with. RUCO is not critical of the
14 Company’s claims regarding the scarcity of water in Arizona and the need for the
15 Commission to address these concerns. RUCO is critical of the accounting treatment that
16 the Company proposes as a solution. The Company has not shown that the proposed
17 solutions cannot nor should not be addressed by normal regulatory accounting. Rather, the
18 Company goes on a rant against traditional ratemaking and claims that CIAC is the root of all
19 evil – it “destroys utility companies.” A-8 at 13. In fact, as the evidence shows, and will be
20 developed further in this Brief, CIAC has benefits for the ratepayer, shareholder and the utility
21 as well.

1 **THE COMMISSION SHOULD TREAT THE PROCEEDS FROM THE ICFAS AS CIAC AND**
2 **APPROVE A CORRESPONDING REDUCTION TO GLOBAL'S RATEBASE**

3 ICFA's are voluntary agreements entered into between Global Parent and landowner's
4 to coordinate the planning, financing and construction of off-site water and wastewater
5 plants. A-7 at 31. During the time period of 2004 through 2008 Global Parent collected
6 \$60,084,123.00 in ICFA proceeds. Id. at 32. During that same period Global Parent spent
7 \$83,080,153.00 on acquisitions and consolidations. Id. According to the Company, none of
8 the ICFA proceeds were used to pay for Global's plant. S-10 at 6.

9 Global Parent accounts for the ICFA fees as deferred revenues until such time as
10 capacity is met at which time the ICFA fees are converted into operating revenue. S-10 at 8.
11 While it has not been established with any degree of certainty what the proceeds from the
12 ICFA were used for, RUCO agrees with Staff's conclusion that the ICFA fees are an integral
13 part of Global's financing of plant used to supply utility service. Id. at 12, R-7 at 8. The
14 Company's proposal, if approved has the effect of keeping what would otherwise be
15 considered CIAC in Global's ratebase. R-7 at 8. The normal ratemaking treatment of CIAC
16 is to treat it as a reduction to ratebase which results in lower rates.

17 As Staff noted, Global Utilities derives all of its external financing other than
18 contributions, advances and WIFA debt, from Global Parent through Global Parents'
19 investment of equity. S-10 at 11. The equity investment was derived from Global Parents'
20 net income, which was largely derived from the ICFA fees. Id. It is not reasonable to
21 assume that Global Parent could collect the ICFA fees absent its relationship to its utilities.
22 Id. at 12. The nature of the ICFA allows for the collection of the fees only in instances where
23 a developer or landowner needs plant for utility service. Id. In short, there is a clear
24

1 connection between the ICFA fees and the utility's plant financing which should not be
2 dismissed as the Company proposes.

3 In fact, from the evidence in the record, it appears that Global Parents use of the
4 ICFA's was contemplated for the purpose of avoiding reductions to its utilities ratebase. This
5 conclusion is supported by the minimal amount of plant paid for by contributions for each of
6 the utility divisions. Id. Global Parent received over \$60 million in ICFA fees, yet Global
7 constructed plant normally paid for by developers. Id. The Commission should not be
8 persuaded by the Company's argument that there is no accounting relationship between the
9 ICFA's and Global's plant.

10 The lack of contributions to pay for Global's plant should come as no surprise given
11 Global's disdain for CIAC. According to Global Utilities' President, Trevor Hill "CIAC destroys
12 utility companies." A-8 at 13. Mr. Hill notes that this is the reason why there is very little
13 CIAC on Global's books. Id. But in truth, CIAC benefits both the ratepayer and the utility in
14 many ways and it is shortsighted to dismiss the importance of CIAC as a ratemaking tool.

15 As regards CIAC, traditional ratemaking practices have been established to insure that
16 utilities do not earn a recovery on and a recovery of capital that is provided by third parties as
17 opposed to utility investors. R-7 at 7. This same ratemaking practice also shifts the risk
18 away from both utilities and their captive ratepayers back to the developer. Id. Typically, a
19 utility earns a rate of return on utility plant in service that has been financed either by capital
20 provided by the issuance of either equity or debt. Id. In addition to receiving a return on this
21 invested capital (i.e. operating income), utilities are also permitted a dollar-for-dollar recovery
22 of it through annual depreciation expense. Id. Both the recovery on and the recovery of
23 investor supplied capital is embedded in the rates that are paid by the utility's customers. Id.
24 at 7-8.

1 In the case of ICFA's, the utility obtains the capital from third parties (typically
2 developers) and not the utilities' investors to construct the plant needed to serve their
3 development projects. Id. at 8. Ordinarily, if the developer provides the capital with no
4 repayment plan, such as the case with ICFA's, it is booked as CIAC and subsequently
5 treated as a deduction from rate base to offset the utility plant that it financed (the same
6 treatment applies to plant built by a third party and contributed to the utility). Id. By
7 deducting the CIAC from the utility plant that it financed, the utility does not earn a return on it
8 that would be recovered in rates. Id. Because CIAC is amortized over time there is no
9 recovery of the contributed plant through depreciation expense because of accounting
10 entries that offset the amount of depreciation expense associated with the contributed plant.
11 Id. This standard ratemaking procedure insures that utilities do not recover funds that were
12 not provided by its investors through the rates that are paid by captive customers. Id. It also
13 shifts the risk away from the utility and ratepayer back to the developer.

14 The risk remains with the developer because if the development never materializes it
15 is the developer and not the utility or the ratepayer who is out of the money. In other words,
16 the standard ratemaking treatment guarantees that current ratepayers do not end up paying
17 for plant intended to serve future ratepayers that do not exist or have left the system. Id. at 9.
18 CIAC solves this problem by shifting the risk associated with the new construction of plant for
19 new development away from the utility and the ratepayers and placing it with the third party
20 developer who must put his or her own funds at risk. Id.

21 Global has creatively avoided this traditional regulatory scheme and proposes a
22 procedure which would greatly advantage its shareholders and deny the ratepayers the
23 benefits and protections associated with traditional ratemaking. As explained above, Global
24 Parent infuses the funds received from the ICFA's into its operating utilities as equity capital

1 as opposed to CIAC. Id. In this manner, Global Utilities earns a return on and a return of
2 capital that was supplied by a third party developer through the rates paid by its captive
3 customers who are now exposed to the risk of having to pay for plant that is intended for
4 customers who may never materialize or have left the system. Id.

5 Mr. Hill's argument that CIAC creates poor infrastructure and weak undercapitalized
6 utilities is not applicable where utility managers use a reasonable mix of debt, equity and
7 third party zero-cost capital (such as CIAC and AIAC) to finance utility plant. Id. at 9. A
8 proper and balanced mix of financing is something that has been accomplished by
9 successful utilities in Arizona without the need for ICFA's. Id. An overreliance on CIAC, or
10 debt and equity for that matter is never a good utility strategy, as it deprives ratepayers of
11 accounting treatments which result in lower rates. The end result of lopsided financing
12 methods is typically unfair and unreasonable rates.

13 The Company could have mitigated and possibly eliminated the opposition it is facing
14 now had it sought approval earlier from the Commission for the ratemaking treatment it
15 proposes. Like every other business decision, when a company decides to buy a weak or
16 distressed utility, the company needs to do a complete financial analysis that includes the
17 ratemaking treatment that the Commission generally allows for developer contributed capital.
18 Id. at 11. If the traditional ratemaking treatment is to treat third party funds as CIAC, the
19 Company should not have assumed that the Commission will approve a radically different
20 type of ratemaking treatment. Id. at 11. Such an assumption the Company makes at its own
21 peril - the Company chose to gamble, and has no one to blame should the Company's
22 request be denied.

1 **RELIEF REQUESTED:** The Commission should treat the ICFA proceeds as CIAC
2 and deduct:

3	PVWC	(\$10,167,233)
4	SCWC	(\$6,105,227)
5	VWC – Town Div.	\$0
6	VWC – GB Div.	\$0
7	WUGT	(\$8,721,514)
8	WWWC	\$0

9 R-2 at 6, RLM-3².

10 **FRANCHISE FEE PASS-THROUGH AND PUBLIC PRIVATE PARTNERSHIP**
11 **AGREEMENT**

12 The issue in dispute between RUCO and the Company concerns the method of
13 collection of the franchise fee. The Company recommends it be permitted to recover a
14 portion of the franchise fee being paid by its parent through an increase in operating
15 expenses and another portion through Private Partnership Agreements ("PPAs" or "P3
16 agreements"). R-4 at 16. RUCO is recommending the Company be allowed to collect the
17 fee only through an increase in the Company's operating expenses in order to allow the
18 recovery of the Company-requested portion of the franchise fees in rates. Id. RUCO is
19 concerned that the collection of the fees through the PPAs may entice the Company to pass
20 additional types of services that are not related to the franchise fee. Id. at 17. RUCO
21 recommends and wants to ensure that these unrelated expenses that are currently being
22 paid by Global Parent not be recovered in rates. Id. at 18. RUCO's recommendation limits

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24 ² These are the net adjustments after amortization.

1 the recovery to three percent of operating revenues and does not allow for a direct pass
2 through to ratepayers. Id. These fees would also be subject to review under RUCO's
3 proposal in the next rate case to ensure only those costs associated with Franchise Fees
4 would be recovered. Id. RUCO's recommendation is one way to assure that these non-
5 related fees are not charged to ratepayers.

6 **RELIEF REQUESTED:** RUCO recommends the Company be allowed to increase its
7 operating expenses only to recover the requested portion of the requested franchise fee in
8 rates. Id. at 16. RUCO recommends that any portion of the franchise fees negotiated
9 through P3 agreements (currently being paid for by the unregulated Global Parent entity) that
10 are not associated with services typically included in a municipal franchise fee not be
11 recovered in rates. R-7 at 14.

12 **DISTRIBUTED RENEWABLE ENERGY RECOVERY AND CONSERVATION**

13 The Company seeks to recover its distributed renewable energy recovery tariff
14 through an adjustor mechanism. R-4 at 5. The Company intends to establish a surcharge
15 which will allow it to recover the costs associated with new plant additions that utilize
16 renewable energy technology. Id. RUCO does not oppose the use of plant additions that
17 employ renewable resources such as solar. Id. Nor does RUCO oppose the recovery of
18 those costs that are reasonable and prudent to achieve that end. RUCO does oppose
19 recovery, however, through the use of an adjustor mechanism. Id.

20 The proposed adjustor mechanism, like the Arsenic Cost Recovery Mechanism
21 ("ACRM") will only consider cost increases in one category of expenses and will ignore
22 changes in revenues, cost of capital, rate base and other expense categories. Ratepayers
23 will not enjoy the benefits of efficiencies or other potential off-sets to costs since the sole
24

1 focus of the step reviews will be the costs associated with renewable energy. This is "single-
2 issue" ratemaking and as such, the Court of Appeals in this state has recognized it is "fraught
3 with potential abuse." See Scates v. Arizona Corporation Commission, 118 AZ. 531, 534,
4 578 P.2d 612, 615 (1978). To the extent the Commission is willing to consider such
5 mechanisms, it should only do so under the most dire and extreme circumstances.
6 Approving a mechanism for the recovery of expenditures for plant additions utilizing
7 renewable technology does not qualify for this extraordinary ratemaking device.

8 The ACRM was the result of a change in the federal law which did not provide water
9 companies with an alternative. R-4 at 8. No one questioned that in order to comply with the
10 new federal arsenic standard, numerous water utilities would have to expend large amounts
11 of capital in a relatively short time to build the infrastructure in addition to the operation and
12 maintenance costs. *Id.* RUCO, the Commission's Staff and the water utilities all understood
13 the unique situation confronting the water utilities because of the new law and worked hard to
14 come up with a cost recovery mechanism that was fair to ratepayers and allowed timely cost
15 recovery. *Id.* While the ACRM raises the same concerns raised by the *Scates* Court, the
16 mechanism became unavoidable given the fact of change in the law and its simultaneous
17 impact on a large number of water systems. *Id.*

18 There is no federal or state law or regulation which requires the use of solar
19 technology or other renewable resources when a water company builds plant additions. In
20 Decision No. 68302, (In the Matter of Arizona Water's rate application for its Western Group,
21 Docket No. W-01445A-04-0650, docketed on November 14, 2005), the Commission noted
22 that
23
24

1 Staff states that adjustment mechanisms have traditionally been
2 used to mitigate the regulatory lag for volatile, very large expense
3 items, and are useful when a commodity constitutes a utility's largest
4 expense, such as for electric utilities where purchased power is the
5 utility's single largest expense (Ludders at 7-8; Ludders Sb. At 6).
6 Decision No. 68302 at 44.

7 At issue in the Arizona Water case was the Company's proposed continuance of an
8 adjustor mechanism to recover the cost for power provided to Arizona Water from APS. Id.
9 The Commission denied the Company's request noting that APS' adjuster had numerous
10 safeguards designed to limit volatility and the evidence in that case did not support a finding
11 that the company's power costs were subject to such a degree of price volatility or
12 uncertainty that it justified an adjustor mechanism. Id. at 46. The Commission further
13 concluded,
14 Undoubtedly based in part on Staff's conclusions in that case, that consistent with numerous
15 prior and subsequent Commission decisions:

16 There is a danger of piecemeal regulation inherent in adjustment
17 mechanisms. Because they allow automatic increases in rates
18 without a simultaneous review of a utility's unrelated costs,
19 adjustment mechanisms have a built-in potential of allowing a utility
20 to increase rates based on certain isolated costs when its other
21 costs are declining, or when overall revenues are increasing faster
22 than costs due to customer growth. Adjustment mechanisms should
23 therefore be used only in extraordinary circumstances to mitigate
24 the effect of uncontrollable price volatility or uncertainty in the
marketplace. Id. at 45-46.

25 The Commission also rejected the use of an adjustor mechanism in a recent
26 Chaparral City Water application. Docket No. W-02113A-04-0616, Decision No. 68176
27 docketed September 30, 2005). In Chaparral the company proposed an adjustor for its
28 purchased water and purchased power expenses that even the Commission determined
29 were significant. Decision No. 68176 at 32-33.

1 Staff does not believe that the incremental cost level or volatility
2 associated with possible rate increases or decreases associated
3 with the Company's water supply are significant enough to justify a
4 purchased water adjustment mechanism in this case, and
5 recommends denial of the Company's request. Regarding
6 purchased sewer expense, Staff does not disagree that purchased
7 power expense is a significant cost for Chaparral City, but points
8 out that the issue to be considered in implementing an adjustment
9 mechanism is not merely whether the cost is significant, but
10 whether the incremental cost level, or volatility, associated with
11 possible rate increases or decreases is significant. Staff asserts
12 that future rate increases the Company projects from SRP and APS
13 do not constitute a level of volatility great enough to warrant the
14 need for a purchased power adjustment mechanism. In particular,
15 Staff differentiates the possible increases in Chaparral City's
16 purchased power expense from the volatility; of APS' constantly
17 changing fuel and purchased power costs, which led to the
18 Commission's recent approval of a Power Supply Adjustor for APS.
19 Id.

20 The Commission agreed with Staff and RUCO that the expenses do not rise to a
21 "...level of volatility that would justify the extraordinary ratemaking treatment..." of an adjustor
22 mechanism. Id. at 33. The Commission concluded:

23 As we stated in Decision No. 56450, there is a danger of piecemeal
24 regulation inherent in adjustment mechanisms. Because adjustor
mechanisms allow automatic increases in rates without
simultaneous review of a Company's unrelated costs, an
adjustment mechanism has a built-in potential of allowing a
Company to increase rates based on certain isolated costs when its
other costs are declining, or when overall revenues are increasing
faster than costs due to customer growth. Such circumstances can
result in increases to ratepayers through adjustors even when the
Company's level of earnings would not warrant a rate increase,
such that the utility's net income is increased outside a rate case. In
addition, as we stated in Decision No. 66849 (March 19, 2004),
adjustment mechanisms may also provide a disincentive for a utility
to obtain the lowest possible cost commodity because the costs are
simply passed through to ratepayers. For these reasons,
adjustment mechanisms should be implemented only under very
special circumstances. Based on the evidence in this proceeding,
circumstances do not exist in this case to justify the risks of
piecemeal regulation inherent in adjustment mechanisms, and we
will not approve the Company's requests. Id.

1 The circumstances in this case do not warrant an adjustor mechanism. The plant
2 costs associated with solar technology do not rise to the level of volatility that it should
3 require extraordinary ratemaking. It has not been shown or even alleged that these costs are
4 not otherwise normal plant expenditures. The proliferation of the number of requests for
5 adjustor mechanisms by utilities in Arizona to recover routine expenses is alarming. Adjustor
6 mechanisms are an exception to this states constitutionally mandated fair value requirement
7 and should only be considered under the most extraordinary circumstance. Those
8 circumstances do not exist here and the Commission should not stretch the exception to
9 include the types of cost under consideration.

10 **RELIEF REQUESTED:** The Commission should deny the Company-proposed
11 distributed renewable energy recovery tariff for an adjustor mechanism. R-7 at 5.

12 **PROPERTY TAX EXPENSE**

13 RUCO and the Company used the same methodology to compute property tax expense. R-
14 2 at 6. The difference in the recommendations is that each party's recommendation is based
15 on its proposed level of annual revenue. Id.

16 **RELIEF REQUESTED:** RUCO recommends adjusting test-year operating expenses by:

18	PVUC	\$609,679
19	SCWC	\$690,540
20	VWC – Town Div.	\$159,024
21	VWC – GB Div.	\$18,061
22	WUGT	\$9,539
23	WVWC	\$25,108

24 See RUCO's Final Schedule RLM-8.

1 **INCOME ANNUALIZATION TO RECOGNIZE POST TEST YEAR CUSTOMER LEVELS**

2 RUCO, Staff and the Company are in substantial agreement with the level of revenue
3 and expenses affected by changes in the number of customers served by the Utility and
4 RUCO's adjustment reflects the customer numbers as of July 31, 2009. R-2 at 7. This
5 adjustment reverses the Company's original recommendation, which was based on reduced
6 end of test year customer counts as computed on the Company's Schedule C-2, page 2. Id.

7 **RELIEF REQUESTED:** RUCO recommends adjusting test-year revenue and
8 operating expenses by:

	<u>REVENUE</u>	<u>EXPENSES</u>
9 PVUC	\$122,612	\$9,516
10 SCWC	\$299,141	\$17,931
11 VWC – Town Div.	\$143,041	\$24,875
12 VWC – GB Div.	\$43,655	\$6,711
13 WUGT	\$0	\$0
14 WWWC	\$0	\$0

15 Id.

16
17 **BAD DEBT EXPENSE**

18 RUCO recommends the unadjusted test year bad debt expense as a fair and
19 reasonable reflection of the historical annual amount.

1 **RELIEF REQUESTED:** RUCO recommends adjusting test-year operating expenses by:

2	PVWC	\$30,477
3	SCWC	(\$4,657)
4	VWC – Town Div.	\$13,954
5	VWC – GB Div.	\$752
6	WUGT	(\$142)
7	WWWC	(\$885)

8 R-2 at 9.

9
10 **DEPRECIATION EXPENSE**

11 This adjustment is specific to PVUC, SCWC AND WUGT. R-2 at 9. This is a
12 companion adjustment to adjustment made to reclassify ICFA discussed above and reflects
13 the amortization of the CIAC and its reduction to the depreciation expense. R-2 at 5-6.

14 **RELIEF REQUESTED:** As shown on Schedule SURR RLM-7, column H, RUCO
15 recommends adjusting test-year operating expenses by:

16	PVWC	(\$823,895)
17	SCWC	(\$494,849)
18	VWC – Town Div.	\$0
19	VWC – GB Div.	\$0
20	WUGT	(\$301,236)
21	WWWC	\$0

22 Id. at 9-10.

1 **INCOME TAXES**

2 This adjustment reflects income tax expenses calculated on RUCO's recommended
3 revenues and expenses.

4 **RELIEF REQUESTED:** As shown on Schedule SURR RLM-7, column G, RUCO
5 recommends adjusting test-year operating expenses by:

6	PVWC	(\$529,621)
7	SCWC	(\$453,722)
8	WVC – Town Div.	(\$26,891)
9	WVC – GB Div.	\$4,167
10	WUGT	\$149,378
11	WVWC	(\$4,360)

12 See RUCO's Final Schedules – RLM-9.

13 **CONTRACTUAL SERVICES – MANAGEMENT FEES**

14 RUCO and the Company are now in substantial agreement with contractual services –
15 management fees. The Company agrees to remove payroll bonus as identified on page 6 of
16 the rebuttal testimony of Company witness Jamie Moe. R-2 at 8.

17 **RELIEF REQUESTED:** As shown on Schedule SURR RLM-7, column F, RUCO
18 recommends adjusting test-year operating expenses by:

19	PVWC	(\$26,716)
20	SCWC	(\$36,448)
21	WVC – Town Div.	(\$55,315)
22	WVC – GB Div.	(\$7,016)
23	WUGT	(\$4,629)
24	WVWC	(\$21,372)

1 R-2 at 8.

2 **CENTRAL ARIZONA GROUNDWATER REPLENISHMENT DISTRICT FEES ('CAGRDR')**

3 The Company is requesting Commission approval to collect CAGRDR fees through a
4 commodity-based pass-through surcharge. R-1 AT 13. The Company is not being charged
5 any CAGRDR fees at this time, because it has not completed the enrollment process. Id.
6 RUCO recommends the Commission deny the Company's proposal to recover the CAGRDR
7 fees at this time since the Company is not being assessed the fee.

8 The CAGRDR fee is collected from landowners or water service providers and is used
9 to purchase water (i.e. excess surface water or recycled water), which is then injected into
10 the ground; thus compensating for groundwater withdrawals. However, landowners or water
11 service providers must enroll in CAGRDR to participate in the program. Id. Since the
12 Company has not enrolled in the CAGRDR at this time, it should be a moot issue from RUCO's
13 perspective.

14 Nonetheless, the Company desires to recover the CAGRDR assessment through a
15 surcharge once it starts to get assessed a fee. Again, this question should be addressed in
16 the Company's next rate case after it has enrolled in the program and is being assessed.
17 Should the Commission believe the issue is ripe now, the Commission should not allow
18 recovery through a commodity based surcharge nor through an adjustor mechanism. The
19 Commission should allow the Company to expense the item which is the standard
20 ratemaking treatment for this type of routine, unexceptional expense.

21 The Commission has already reviewed and denied a similar request by another
22 regulated water utility (Johnson Utilities, LLC). Id. at 14. In Decision 64598, dated March 4,
23 2002, the Commission determined that the CAGRDR fee cannot be treated as a pass-through
24

1 tax, because it is not a "privilege, sales or use tax" since the CAGR D fees are not based on
2 sales revenue. Id. However, In Decision 64598, the Commission also ordered the matter of
3 the CAGR D fee be addressed in Johnson Utilities' next full rate case. On March 31, 2008
4 Johnson Utilities did file a rate case in which it requested recovery of the CAGR D fee by a
5 commodity-based pass-through surcharge. Id. The difference, however, is that Johnson
6 Utilities is enrolled in the program and is being assessed the fees. As of the filing of this
7 testimony, the Commission has not made a decision on Johnson Utilities rate case.
8 However, RUCO maintains that in this case, like in Johnson, if the Company is assessed a
9 CAGR D fee it should be expensed and not be treated as a pass through or recovered
10 through an adjustor.

11 **RELIEF REQUESTED:** The Commission should not allow any adjustment for
12 CAGR D fees at this time. R-1 at 14.

13 **COST OF CAPITAL**

14 **CAPITAL STRUCTURE AND COST OF DEBT**

15 Global and RUCO agree on capital structure and cost of debt for each district except
16 for the Palo Verde and Santa Cruz districts. R-7 at 14-15. For the WUGT, RUCO is
17 recommending an operating margin of 8.03 percent due to the negative rate base. R-6 at 51,
18 R-7 at 18. The Company proposes a capital structure of 54.65% equity and 45.35% debt for
19 Palo Verde and 56.07% equity and 43.93% debt for Santa Cruz. R-6 at 50. RUCO's
20 recommended capital structure for both districts is 62.11 percent equity and 37.89% debt. R-
21 6 at 51

22 RUCO's capital structure recommendation is a blanket capital structure based on the
23 combined amounts of long term debt and common equity of each of Global's six operating
24

1 systems. Id. RUCO believes that a capital structure that produces a lower cost of common
2 equity is appropriate for Global because publically traded companies with Global's actual
3 level of equity would be perceived as having average to extremely low financial risk. Id. With
4 the lower risk the investor expectation would be a lower return on common equity. Id.
5 RUCO's recommended capital structure produces a lower weighted cost of common equity
6 which is consistent with the lower risk that the Company faces when compared to the more
7 leveraged companies used in RUCO's proxy of Companies. Id. RUCO's recommendation is
8 also closer to the 40% debt/ 60% equity capital structure which the Commission has favored
9 in the past.

10 Finally, RUCO's capital structure is supported by the Commission's reasoning in the
11 recent Gold Canyon Sewer Company case (Docket No. SW 02519A-06-0015). Id. In Gold
12 Canyon, the Commission adopted both a hypothetical capital structure and a hypothetical
13 cost of debt in order to remedy a capital structure comprised of 100 percent common equity.
14 In Decision No. 70624, dated November 19, 2008, the Commission noted the following:

15 We agree with RUCO's hypothetical structure of 40 percent debt and
16 60 percent equity. A capital structure comprised of 100 percent equity
17 would be viewed as having little to no financial risk. The proposed
18 capital structure adopted by the Commission will bring the Company's
19 capital structure and weighted cost of capital in line with the industry
20 average and it will result in lower rates for the customers of the
21 system. We therefore adopt a hypothetical capital structure of 40
22 percent debt and 60 percent equity. Decision No. 70664 at 14.

23 Likewise, RUCO's recommend capital structure for all of the districts in this case is in line
24 with the industry average and should be adopted.

25 The difference in the cost of debt recommendations for the Palo Verde and Santa
26 Cruz districts results from the calculations used by the respective parties to ascertain the
27 recommended cost of debt. RUCO calculated a weighted average of the Company-proposed

1 costs using the projected dollar amounts of long-term debt for each of the six operating
2 systems. The result is RUCO's 6.44 percent cost of long term debt. R-6 at 52. Again, from
3 RUCO's perspective, using the weighted average of all of the districts provides a result that is
4 more in-line with the industry average.

5 **COST OF EQUITY**

6 Both Staff and the Company are recommending a cost of equity of 10.00 percent. S-7
7 at 20. Neither Staff nor the Company conducted an actual cost of equity analysis. Id. at 21.
8 RUCO is recommending a cost of common equity of 9.00%. Id.

9 RUCO's recommendation is based on a complete cost of equity analysis. RUCO
10 originally recommended a cost of equity of 8.01 percent. R-6 at 7. RUCO's original
11 recommendation was the mean average of the result of its Discounted Cash Flow ("DCF")
12 analysis and Capital Asset Pricing Model ("CAPM") analyses. RUCO utilized both a sample
13 of publically traded water providers and a sample of publically traded natural gas distribution
14 companies in its analyses. Id. RUCO's analyses also factored in the current economic
15 environment which caused RUCO to change its recommendation in its surrebuttal case. R-7
16 at 15.

17 Since RUCO filed its direct testimony on October 26, 2009, the state of the economy
18 has improved. R-7 at 15. The stock market has shown signs of improvement, and there are
19 reports in the financial press which anticipate Federal Reserve actions to raise interest rates.
20 Id. Value Line analysts recently summed up the improving economic situation in its weekly
21 Economic and Stock Market Commentary in its Selection & Opinion publication dated
22 November 27, 2009:
23
24

1 The long recession has faded into history, brought to an end in the third
2 quarter when the nation's gross domestic product increased by a solid
3 3.5%. That notable rebound followed four straight quarters of
4 contracting economic activity. The recession was the worst in decades.
5 The third quarter's surge in activity, which was underpinned to some
6 degree by federal programs to assist the troubled auto and housing
7 industries, may not continue to the same degree in the current period.
8 In fact, we expect GDP growth to ease to a level closer to 2.0%-2.5%
during the fourth quarter. We think that the evolving expansion will then
remain on a similarly subdued path for much of 2010. Thereafter, an
increasing level of aggregate demand is likely to develop—with belated
help from better employment and housing trends—and push the
economy onto a materially faster track by 2011. The 3.0%, or better,
pace of economic growth that we see evolving by that time is likely to
then continue through the middle years of the coming decade.

9 Id.

10 Value Line reported the following:

11 Unlike the economy, which has proceeded on an irregular path during
12 the formative stages of its comeback, the stock market, which lost more
13 than half of its value from October, 2007 through March, 2009, has
14 come roaring back. At press time, the Dow Jones Industrial Average
15 was up about 60% from its bear market lows of this past March.
16 However, it was still some 25% below the record highs set in late 2007.
17 The market's revival, which began as the worst fears on the credit and
business fronts didn't materialize, has been sustained with an assist
from the Federal Reserve, the government's stimulus efforts, and the
aforementioned revivals on the economic and profit fronts. Now, with
valuations having become a little stretched following eight months of
steady market increases, the bulls may have to deliver even more good
news to keep the rally going.

18
19 Id. at 15-16. Based on these new developments, RUCO increased its recommended cost of
20 equity capital from 8.01 percent to 9.00 percent.

21 By comparison, neither the Company nor Staff changed their cost of equity analysis to
22 reflect the changes in the current economic environment. The Company's recommended 10
23 percent cost of equity adopted in prior Commission decisions, there was no need to counter
24 RUCO's analysis. A-13 at 38. The Company's position is that developing an independent

1 cost of equity analysis is expensive and time consuming. Id. at 36. Staff and the Company
2 believe that recent Staff recommendations in the Arizona-American case (Docket No. W-
3 101303A-08-0227) and Commission decisions are in line with the Company's
4 recommendation and that is enough to support its position. Id. at 37, A-12 at 28.

5 Staff relied on it's "...underlying analysis" from the recent Black Mountain case
6 (Docket No. SW-02361A-08-0609) which Staff believes can be reasonably applied to the
7 current case since the analysis is "...current and is based on a sample of water companies."
8 S-10 at 29. It appears that Staff is suggesting that it is no longer necessary to do a cost of
9 equity analysis for a utility if there is a current case pending that used a sample of the same
10 type of utilities in its cost of equity analysis. There is no question that this approach would
11 steam-line the analysis and save on the costs, but it would come at the expense of a well
12 reasoned, well thought out and fair cost of equity recommendation.

13 Even Staff acknowledges that there are "...differences in circumstances between
14 utilities that can cause differing results in the specified estimated equity costs for each." Id.
15 One would think that any argument in favor of Staff's stream-lined approach would end there.
16 After all, Staff has acknowledged the exact reason why any possible benefit of stream-lining
17 the process would be out-weighed by the harm of a methodology that does not distinguish
18 the differences in circumstances that exist between Black Mountain and Global. Surprisingly,
19 Staff simply disregards the differences in circumstances in favor of convenience.

20 Finally, the Commission itself has recently dismissed Staff and the Company's
21 argument. In the appeal of Gold Canyon Sewer Company, currently pending before the
22 Arizona Court of Appeals, the Commission addressed a similar argument made by Gold
23 Canyon. Commission Docket No. SW-02219A-0015, No. 1 CA-CC-09-0001, 0002. On
24 appeal, Gold Canyon argued that in a rate case involving its affiliate, Black Mountain Sewer

1 Company the capital structure component of the cost of capital analysis were virtually
2 identical and therefore entitle to the same outcome. See Appellee Arizona Corporation
3 Commission's Responsive Brief at 38. Therefore, argues Gold Canyon, any other outcome
4 would be arbitrary and unlawful.

5 In response, the Commission argues that there are a number of factual differences
6 between Gold Canyon and Black Mountain, noting the differences in rate base, customer
7 count and the size of the proposed rate increase. Id. at 38-39. The Commission went on to
8 argue:

9 The issues presented in a rate proceeding, the positions advanced
10 by the parties during the proceeding, and any other factors that the
11 Commission deems relevant may all contribute to different treatment at
different times, if warranted. Id. at 40.

12 Not surprisingly, the Commission in responding to Gold Canyons' argument argued:

13 The Commission decides each case on the record before it. The
14 issue is whether the Commission's decisions on rehearing are
15 supported by substantial evidence in the record. The Company has
16 not demonstrated that the Commission's decision in Black Mountain
17 binds the Commission to certain determinations in Gold Canyon, nor
has the Company shown that the Commission's decisions on rehearing
are not supported by substantial evidence in the record. Id at 41.
(Emphasis added).

18 The matter here is not on rehearing and the focus here is on cost of equity and not capital
19 structure, however the standard is the same and the focus is on cost of capital so the
20 analogy is certainly relevant. In this case, as concerns the cost of equity neither the
21 Company nor Staff have "... demonstrated that the Commission's decision in Black Mountain
22 binds the Commission to certain determinations in..." in this case.

23 Should the Commission adopt Staff and the Company's approach, the Commission
24 would be establishing a precedent that favors convenience over a thorough and complete

1 financial analysis- a very dangerous precedent – especially concerning a ratemaking element
2 as important as a utilities cost of equity. It is true that estimating an appropriate cost of equity
3 is more of an art than a science, but each utility is different from a financial standpoint in so
4 many ways that applying a generic approach to estimating a cost of equity is simply
5 misplaced and would establish bad policy.

6 The differences are many, substantial and obvious - Black Mountain, Arizona
7 American and Global all have different operating expenses and operating revenues. Each
8 has different capital structures and rate bases. Each utility has a different parent company, a
9 different level of growth, a different level of risk. Each utility and parent has different
10 operational philosophies which could affect its cost of equity. Global Parent has spent
11 millions and millions of dollars on acquiring distressed utilities with little or no ratebase in its
12 efforts to achieve TWM, a philosophy not shared by Black Mountain or Arizona American.
13 Global's Parent as well as Global Utilities has made it clear that they do not favor CIAC as a
14 means of financing plant. CIAC shifts the risk from the utility and the ratepayer back to the
15 developer. R-7 at 7-8. CIAC reduces the Companies overall risk which, all things being
16 equal, lowers the CAPM results which lowers the cost of equity. Again, all of these
17 circumstances are different and show why a generic application of another utilities cost of
18 equity analysis should not be applied to Global.

19 Moreover, as made clear above, neither Staff nor the Company's recommendation is
20 supported by substantial evidence. In order to survive a challenge on appeal, the
21 Commissions decision must be supported by substantial evidence. ¹ Tucson Elec. Power
22 Co. v. Arizona Corp, Comm'n, 132 Ariz. 240, 243, 645 P. 2d 231, 235 (1982). So even is
23 the Commission determines that Staff and the Company's proposals are fair, they still are not
24 supported by substantial evidence based on the record in this case. Neither Staff nor the

1 Company did a cost of equity analysis so there is no question that their recommendations are
2 not based on substantial evidence. The Commission should reject Staff and the Company's
3 cost of equity recommendations.

4 **RELIEF REQUESTED:** The Commission should adopt RUCO's recommended
5 blanket capital structure for Palo Verde and Santa Cruz districts of 62.11 percent equity and
6 37.89% debt. The Commission should also adopt RUCO's recommended operating margin
7 of 8.03 percent for WUGT. Id. at 51, R-7 at 18. Further, the Commission should adopt
8 RUCO's recommended cost of common equity of 9.00%. R-7 at 21.

9 **RATE DESIGN**

10 RUCO's proposed rate design is consistent with the Company's proposed rate design,
11 but reflects RUCO's recommended revenue requirement. R-8 at 3. RUCO's recommended
12 rate design is based on cost of service. RUCO did not prepare a consolidation proposal
13 because RUCO is not convinced that the Company's consolidation proposal is in the best
14 interests of the ratepayers whose rates would be based on cost of service – Palo Verde,
15 Willow Valley and Santa Cruz ratepayers. R-5 at 3.

16 The Company is proposing to consolidate only three systems (Valencia Town,
17 Valencia Greater Buckeye and Water Utility of Greater Tonopah. Id. The Company's
18 explanation for only partial consolidation of the all the districts is to mitigate rate shock for
19 one of the systems – WUGT. R-5 at 3. The costs for WUGT would shift to the customers of
20 the other two systems. Id. The Company argues that WUGT's 360 customers will face an
21 extremely large rate increase without consolidation. Id. at 4. According to the Company,
22 WUGT required substantial upgrades, including arsenic and fluoride treatment, point of use
23 treatment systems and infrastructure which was mandated by Commission orders. Id. All
24

1 three of the utilities that the Company proposed be consolidate have a total of 6,000
2 customers. Id. From the Company's perspective, the aforementioned infrastructure costs
3 can be spread across this larger customer base. Id.

4 The problem with the Company's perspective is that Valencia Town and Valencia
5 Greater Buckeye's ratepayers are unlikely to derive any meaningful contribution toward any
6 reciprocal infrastructure improvements from WUGT's ratepayers in the future. Id. at 4-5.
7 Valencia's ratepayers would bear the brunt of subsidizing WUGT. Accordingly, RUCO
8 believes that consolidation in this case is not in the best interests of all of the ratepayers, and
9 particularly Valencia's ratepayers.

10 **PHASED-IN RATES**

11 RUCO is recommending that the Commission adopt the Company-proposed three-
12 year phase-in of rates for Palo Verde Utilities Company that will generate RUCO's
13 recommended level of operating revenue. The Company is also requesting phased in rates
14 for the Palo Verde Utilities Company wastewater operating system.

15 In the absence of a phased-in rate proposal, there would be a drastic rate increase for
16 Palo Verde Utilities Company ratepayers. Id. at 7. Under RUCO's recommended level of
17 operating revenue, ratepayers would experience a monthly charge of \$58.63 per month or a
18 77.66 percent increase in existing rates. This amounts to an additional \$25.63 per month
19 over the present rate of \$33.00 per month. Given the magnitude of the increase and current
20 economic conditions, RUCO agrees with the Company that phased-in rates are warranted.
21 See RUCO's Final Schedules RLM-RD-3.

REBATE THRESHOLD RATES

Global Utilities is requesting a volumetric rebate that allows residential customers, who achieve reductions in water consumption, to realize an immediate reduction in volumetric charges when their consumption level is below a rebate threshold volume amount. R-5 at 8. The volumetric rebate is one of a three element plan that makes up the Company's Rebate Threshold Rate ("RTR") structure. The other two elements include six volumetric tiers, as opposed to the more common three tier rate structure, and revenue decoupling through an increased minimum monthly charge. Id.

RUCO is recommending that the Commission adopt the Company-proposed six tier rate structure and has increased the minimum monthly charge for each of the five water providers included in the Company's filing. Id. at 8. RUCO, however, does not support the Company's proposal regarding the volumetric rebate or the decoupling proposal. RUCO believes that the six-tier rate structure and the increased monthly minimum will send a proper price signal to conserve water. Id. While RUCO definitely supports programs to encourage water conservation, RUCO believes that the volumetric rebate is flawed because the rebate will not properly incent conservation because rebates are awarded to all customers who consume less than the median amount, regardless of whether those customers have always been below the median point prior to the implementation of the rebate program. Furthermore, rebates would not be given to those high use customers who demonstrably reduce their consumption, yet still fall above the median amount. Id.

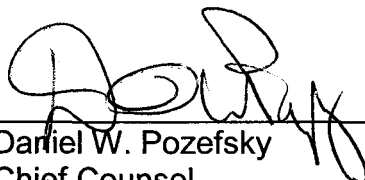
1 **CONCLUSION**

2 RUCO recommends that the Commission treat the ICFA proceeds as CIAC.

3 RUCO further recommends the Commission should adopt RUCO's recommended
4 capital structure for Palo Verde and Santa Cruz districts of 62.11 percent equity and 37.89%
5 debt and an operating margin of 8.03 percent for WUGT. Id. at 51, R-7 at 18. Further, the
6 Commission should adopt RUCO's recommended composite cost of common equity of
7 9.00%. R-7 at 21.

8 Finally, in addition to all of the other recommendations listed in this Brief, RUCO
9 recommends that the Commission adopt RUCO's rate design, impose a three-year phase in
10 of rates for Palo Verde Utilities Company, and reject the Company's volumetric rebate
11 proposal and decoupling proposal.

12
13 RESPECTFULLY SUBMITTED this 5th day of February, 2010.

14
15 
16 Daniel W. Pozefsky
17 Chief Counsel
18

19 AN ORIGINAL AND THIRTEEN COPIES
20 of the foregoing filed this 5th day of
February, 2010 with:

21 Docket Control
22 Arizona Corporation Commission
1200 West Washington
Phoenix, Arizona 85007
23 COPIES of the foregoing hand delivered/
24 mailed this 5th day of February, 2010 to:

1 Dwight D. Nodes, Asst. Chief
Administrative Law Judge
2 Hearing Division
Arizona Corporation Commission
3 1200 West Washington
Phoenix, Arizona 85007

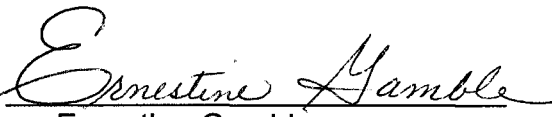
4 Janice Alward, Chief Counsel
5 Legal Division
Arizona Corporation Commission
6 1200 West Washington
Phoenix, Arizona 85007

7 Steven M. Olea, Director
8 Utilities Division
Arizona Corporation Commission
9 1200 West Washington
Phoenix, Arizona 85007

10 Wesley C. Van Cleve, Attorney
11 Legal Division
Arizona Corporation Commission
12 1200 West Washington
Phoenix, Arizona 85007

13 Michael W. Patten
14 Timothy Sabo
Roshka, DeWulf & Patten, PLC
15 One Arizona Center
400 East Van Buren St., Ste.800
16 Phoenix, Arizona 85004

17 Greg Patterson
916 W. Adams – 3
18 Phoenix, Arizona 85007

19
20
21 By 
Ernestine Gamble
22 Secretary to Daniel Pozefsky
23
24